

COMMONWEALTH OF VIRGINIA  
STATE CORPORATION COMMISSION  
AT RICHMOND,

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COMMONWEALTH OF VIRGINIA, ex rel.

DOCUMENT CONTROL

STATE CORPORATION COMMISSION

Ex Parte: In the matter of  
Adopting a Revision to the Rules  
Governing the Virginia Securities Act

CASE NO. SEC-2009-00022

RESPONSE OF THE DIVISION OF SECURITIES AND RETAIL FRANCHISING TO  
PUBLIC COMMENTS ON PROPOSED AMENDMENTS TO THE RULES AND FORMS  
GOVERNING THE VIRGINIA SECURITIES ACT

COMES NOW the Division of Securities and Retail Franchising, by counsel, and submits their responses to comments filed with the State Corporation Commission ("Commission") regarding proposed amendments to Title 21 of the Virginia Administrative Code entitled "Rules and Forms Governing Virginia Securities Act" ("Rules"). The Division states as follows:

1. On May 15, 2009, the Securities Industry and Financial Markets Association ("SIFMA") filed their comments to the Division's proposed amendments to the Rules. Specifically, SIFMA commented that the Division's proposed amendment to conditions number 1, 3 and 5 of Proposed Rule 21 VAC 5-20-135 should be modified from a five-year requirement to a three-year requirement so as to conform to the Securities & Exchange Commission's ("SEC") position on the matter.

2. Additionally, SIFMA commented that conditions numbered 6, 7 and 9 governing annual certification requirements of Rule 21 VAC 5-20-135 appeared duplicative and should be modified.

3. The Division, having considered SIFMA's comments, is in agreement with the proposed modifications to conditions number 1, 3 and 5 and recommends that these conditions should be modified from a five-year requirement to a three-year requirement. The Division also

finds the language of conditions numbered 6 and 7 to be duplicative and proposes that condition number 6 be eliminated. All other proposed amendments to Rule 21 VAC 5-20-135 should remain unchanged.

4. On May 15, 2009, Shawbrook filed their comments to the Division's proposed amendments to the Rules. Specifically, Shawbrook requested modifications to Rule 21 VAC 5-80-145 and Rule 21 VAC 5-80-160.

5. Shawbrook commented that the proposed language of Rule 21 VAC 5-80-145 A.1.(a)(2) addressing what constituted "custody" of client assets was imprecise and could be construed to mean that certain transactions conducted by investment advisors would imply having "custody" of a client's assets.

6. The language of Rule 21 VAC 5-80-145 A.1(a)(2) does not create custody in any of the situations described by Shawbrook in their comments unless payment of funds to a client physically goes through an investment advisor's accounts or directly under the investment advisor's custody. It has been the Division's experience that custodians have safeguards in place to insure these types of transactions would never allow anyone other than the client to have actual custody. Accordingly, when transfers are made to clients' secondary accounts or direct payments are made to clients, the Division would have no basis to seek to enforce the custody requirements of the Rule. The changes requested to the proposed regulation are not necessary at this time.

7. Shawbrook also commented on the client notification requirements imposed on a registered investment advisor in subsection B.1.(c) of Rule 21 VAC 5-80-145. The language in the Rule does not apply to the situations described by Shawbrook in their letter. As noted in Shawbrook's letter, the client in the situations described is opening the accounts. In the case of

the situations described by Shawbrook, the investment advisor would not have to send any type of notice under the proposed Rule. The modifications requested to the proposed regulation are not necessary at this time.

8. Shawbrook further commented that subsection C.5.(a) of Rule 21 VAC 5-80-145 did not provide an adequate definition of "beneficial owner." The Division, having considered Shawbrook's comments and concerns regarding the exclusion of beneficiaries of parents, grandparents, spouses, siblings, children, and grandchildren from the exception created in Rule 21 VAC 5-80-145 C (5)(a), proposes the following modification to the Division's initial proposal:

The beneficial owner of the trust is a parent, a grandparent, a spouse, a sibling, a child, or a grandchild, or the legal beneficiary of the trustee. These relationships shall include "step" relationships.

All other proposed amendments to Rule 21 VAC 5-80-145 should remain unchanged.

9. Shawbrook also commented on Rule 21 VAC 5-80-160 F 1. and 3. regarding the continuing obligations of an investment advisor's backup disaster plan upon an investment advisor's death or from the incapacity of key advisory persons. The Division believes the standards imposed by this Rule are reasonable and were already required by the fiduciary relationship inherent with investment advisors. The rule simply clarifies some of the fiduciary responsibilities that investment advisors have always had regarding their client's assets when dealing with a disaster or incapacity or death of an advisor.

10. The Division, having considered Shawbrook's comments, in order to further clarify fiduciary responsibilities, proposes the following additional language to the Commission's initial proposal for Rule 21 VAC 5-80-160 F (1) and (3):

F. Establish and maintain a written disaster recovery plan that shall address at a minimum:

1. The identity of individuals that will conduct or wind down business on behalf of the investment advisor in the event of death or incapacity of key persons;

3. Means for clients' accounts to continue to be monitored until an orderly liquidation, distribution or transfer of the client portfolio to another advisor can be achieved; or until an actual notice to the client of investment advisor death or incapacity and client control of their assets occurs;"

All other proposed amendments to Rule 21 VAC 5-80-160 should remain unchanged.

WHEREFORE, the Division requests the Commission consider the foregoing modifications to the Division's proposed amendments to the Commission's Rules.

Respectfully submitted,

DIVISION OF SECURITIES AND  
RETAIL FRANCHISING

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